



Task Force 04

TRADE AND INVESTMENT FOR SUSTAINABLE AND INCLUSIVE GROWTH

How to make EU unilateral trade and sustainability policies work for the Global South?

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Abstract

The European Union (EU), a major trade player, is unilaterally enacting sustainability standards that might have negative economic impacts on developing countries and might miss their goal of strengthening sustainability worldwide. These standards are part of the EU's effort to combat climate change and environmental degradation under the EU Green Deal. Most notable examples include the Carbon Border Adjustment Mechanism (CBAM), the EU Renewable Energy Directive (EU RED), and the EU Deforestation Regulation (EUDR). This policy brief outlines the challenges of unilateral trade policies for the Global South based on ongoing research on EUDR and RED, and presents actionable policy recommendations, addressing a key question: where to focus efforts to mitigate the negative spillovers of unilateral trade measures and how? Our discussion is built on four fronts: (1) the impact of EU trade policies on Brazilian exports, (2) the impact of EU trade policies on smallholders, (3) the role of private standards in complementing public sustainability policies, and (4) the current perception of the Global South regarding EU trade policies (EUDR, more specifically).

Diagnosis

The multiplication of unilateral sustainable trade regulations poses difficult trade-offs. Examples of such regulations are the EU Carbon Border Adjustment Mechanism (CBAM), the EU Deforestation Regulation (EUDR) and the EU Renewable Energy Directive (EU RED). On the one hand, the EU plays a crucial role in strengthening sustainability in trade. Its actions can further boost the credibility of sustainability commitments by EU's trade partners. Moreover, EU's unilateral regulations tend ever more to engage with mixed forms of governance (public and private), potentially improving enforcement and cooperation. Given the mixed effects of existing policies and voluntary sustainability initiatives alone (Schleifer and Sun 2020) and the capacity gap of public authorities to tackle sustainability (Coelho-Junior et al., 2022), especially in developing countries, such mixed forms of governance could be good news (Marx, Depoorter, and Vanhaecht, 2022). On the other hand, the extraterritorial enforcement of unilateral sustainability standards can be seen as illegitimate and may generate negative effects on vulnerable populations, climate change mitigation and intergenerational justice. Hence, if not carefully balanced against all interests at stake, EU unilateral sustainability standards risk missing their objective while not contributing to or even worsening economic, social and environmental conditions in developing countries. CBAM, for instance, is sometimes projected to have strong distributional effects across countries (Zhong and Pei, 2022).

For these reasons, Indonesia and Malaysia filed a World Trade Organization (WTO) complaint against the EU, claiming that the EU Renewable Energy Directive II (RED II)

was discriminatory.¹In particular, both countries pointed out that the EU's unilateral sustainability standards on biofuels went beyond what was necessary to achieve a legitimate objective and that they did not sufficiently take into account circumstances specific to developing countries. However, based on the findings of the panel, the EU's unilateral sustainability standards within the scope of RED II are, in principle, compatible with WTO obligations. Despite that legal outcome, concerns over the discriminatory nature of unilateral trade policies remain. Additional WTO complaints are a possibility, and ongoing tensions between the EU and a number of developing country governments are already a reality (Valor Econômico, 2023). Therewith, the unilateral ethos of such regulations and the expectations of mixed impact on the ground could foster negative attention cascades that might hinder sustainable development in the future (Halpin, 2011).

Bearing the above in mind, what should and could be done to mitigate the legitimacy issues of EU's unilateral/"autonomous" sustainability regulations and foster their positive long-term outcomes? This study projects the impacts of unilateral trade policies, particularly the ones put forth by the EU. We focus on original evidence produced around RED and EUDR. We divide those challenges into two processes: inputs (input legitimacy) and outputs (output legitimacy), a common framework used to assess legitimacy issues in public and international policies (Lindgren and Persson 2010; Scharpf 2003).

¹ However, the panel found several deficiencies in the design and implementation of EU indirect land use change (ILUC) risk criteria and in the way the EU prepared and published the policy. Specifically, the EU should have consulted with other economies more when introducing RED II, and the data used for the ILUC-risk criteria was considered insufficient and therewith discriminatory.



As for input legitimacy, or the ability of the EU to assure a fair process involving EUDR and other unilateral sustainability policies, a key difficulty is that domestic laws are, by definition, directly accountable to domestic constituents only. With the growing salience of sustainable trade for the EU public, the EU Commission has a lower and lower ability to exercise policy entrepreneurship and is ever more constrained by EU domestic interests (Cezar, 2022), which may not align with the interests of the Global South. As sustainability policies become more burdensome and rigorous, the costs imposed on those living up to such standards increase. So does the pressure to ensure that foreign products coming into the EU abide by similarly rigorous standards.

Also relevant for input legitimacy are the internal decision-making processes within the EU. As it is, the EU Green Deal related measures are designed under the leadership of the Directorate-General (DG) for Climate Action, with DG Trade on the sidelines. This explains to some extent the current regulatory and practical challenges in the implementation process of trade-related measures within the scope of the EU Green Deal framework that require extra-territorial application. A scenario of increased legal disputes in international trade due to unilateral EU regulations could lead to legal uncertainty and market distortions. Both the EU and third parties could achieve mutually beneficial outcomes from a strategic harmonization and effective application of existing and emerging policy options (Sotirov et al., 2022). But first, this may need a recognition by the parties of possible flaws in legality rules and systems; an adaptation time by exporting countries; and the search for joint solutions to mitigate the risks of trade in illegal and unsustainable goods.

As for output legitimacy, or the effects of the policies on the ground, some challenges also persist. Recent studies show that taking up the certifications required for accessing the EU market under the RED regulations has mixed effects on relevant socioeconomic

variables in Brazil (Cezar, Camargo, and Mello, 2024). To be precise, abiding by EU's biofuels requirements increases EU exports in municipalities that traditionally exported the most to the EU while reducing exports in municipalities with lower production, thus potentially altering the geography of trade in Brazil. Besides, ongoing research finds that the number of small and medium properties declines in highly-exporting municipalities with units that comply with certification requirements by RED when compared to municipalities without certified units (Figure 1). In the case of EUDR, further studies project some potential negative effects on small producers, indigenous peoples and traditional communities in production countries outside the EU. The projected negative effects range from market exclusion to an increased risk of land conflicts (Zhunusova et al., 2022).

There is also a real risk that EU unilateral trade and sustainability measures reach into the void in terms of achieving overarching sustainability goals if only exporters re-arrange their production into EU-destined and other goods without improving sustainability in production overall. Despite supply chains like Brazilian soy that may be more equipped to comply with EUDR standards, there is a risk of segmentation, which undermines the effectiveness of such regulations. This could create compliant market niches in Europe at the cost of non-compliant ones, particularly in developing regions. Although there are still limited studies on the impact of the EU regulations on producing countries, there have been some calls for change. For instance, state-sanctioned rules (including market bans) for risk commodities; better supply chain traceability and governance through international cooperation (Sotirov et al., 2022); and independent verification processes to ensure legality and deforestation-free status, with effective dispute resolution mechanisms (Escobar et al., 2020).

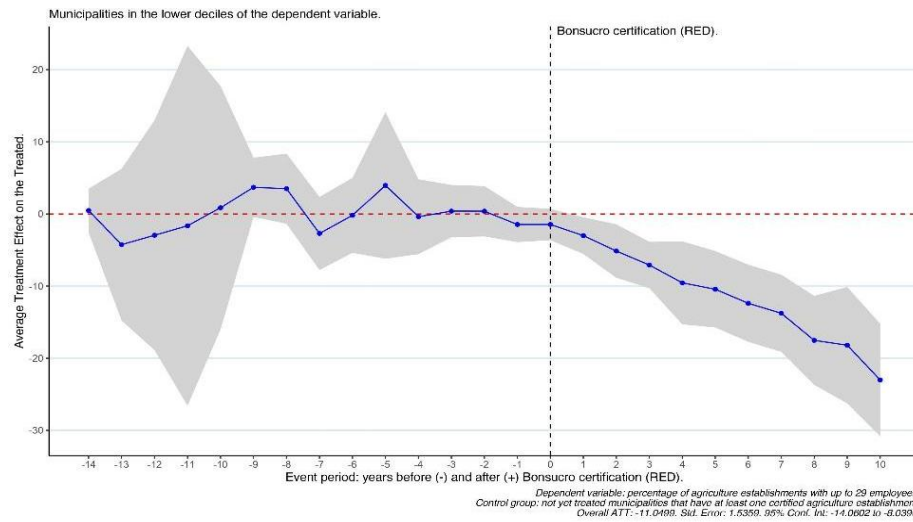


FIGURE 1. The effects of RED-compliant certification (blue) on the number of small producers in Brazilian municipalities.

Source: Cezar, Sun, and De Franco (2024).

Recommendations

The issues discussed above could point to the potential for negative externalities of unilateral trade policies on trading partners. Since unilateral trade policies are meant to offer efficacy in climate change mitigation and environmental degradation, addressing such negative externalities is crucial for at least two motives: (1) negative externalities can undermine the global conservation output via e.g. trade diversion and (2) they may generate feedback leading to public questioning against sustainability policies in the future, further limiting the ability of such policies to achieve ambitious climate change mitigation targets and to reduce environmental degradation.

Input Legitimacy - Dialogue with production countries

In order to mitigate the loss of input legitimacy associated with unilateral trade policies, it is key to foster a regular and transparent dialogue between the EU and the Global South countries to better understand country-specific concerns and needs in sustainability regulation. To do so, it is key to:

- G20 countries should push for the establishment of further mechanisms for ongoing consultation and collaboration to ensure that regulations are fair, inclusive, and considerate of the specific circumstances of each country, besides the ongoing mechanisms of public consultation offered by EU's "Have Your Say" platform and potentially involving further *in loco* discussions with local stakeholders across the Global South, facilitated by EU representations abroad.
- G20 should encourage Global South countries to integrate EU trade regulations into their national policies and strategies to enhance effectiveness and

implementation, expanding comprehensive collaborations on adaptation and capacity building.

Input Legitimacy - Leveraging international institutions

International institutions can serve as an "honest broker" between the promoters of unilateral initiatives and those affected by them, potentially mitigating legitimacy concerns in the Global South. To meet that objective, it is crucial to:

- G20 should reinforce the role of international organizations and forums, such as the World Trade Organization (WTO)²United Nations Environment Programme (UNEP) and the United Nations Conference on Trade and Development (UNCTAD), to facilitate dialogue, cooperation, and capacity-building efforts.
- Strengthen the inclusion of Global South perspectives and interests in international commodity organizations in order to enable the creation of fair new standards in sustainability.
- Advocate for greater inclusion and recognition of Global South perspectives and interests in global trade discussions and decision-making processes, with international institutions working as “honest brokers” of the debate.
- Policy entrepreneurs within the WTO should build upon the RED dispute to leverage the relevance of taking account of the needs of developing countries to reinforce the strength of mechanisms of fair participation and for the data used to

² This is particularly relevant, since the WTO General Exceptions focus on the enforcement of non-discrimination and policy coherence. If these requirements are met, extra-territorial application of sustainability standards that were not consulted with the Global South is possible (Sieber-Gasser, 2021).

assess compliance with the standard to be transparent, scientific, and non-discriminatory.

Output Legitimacy - Clarification on EU standards, especially due diligence and the country's benchmarking system

- G20 should constantly push the EU to provide clear and accessible guidelines on due diligence requirements (e.g., EUDR) to help third parties understand and comply with EU standards, while swiftly complying with WTO decisions under DS600.
- Reevaluate the need for the EUDR to adopt country's benchmarking systems that classify countries in relation to their compliance risk which could interfere with their competitiveness while third parties adapt to EU standards.

Output Legitimacy - Coherence in decision-making processes

- Consider the regulations of producing countries to avoid overlapping of standards or policies that lead to problems with national sovereignty.
- Ensure domestic alignment and policy coherence between EU trade regulations and broader EU environmental policies to avoid conflicting objectives in promoting sustainable development.

Output Legitimacy - Efficacy of EU sustainability standards

- Collaboration among G20 countries through knowledge and technical support (e.g., technical-scientific cooperation programs) considering their needs and strengthening their capabilities.

- Integration of market-based incentives (e.g., price premium, enhanced access to export) into EU standards to increase compliance in developing countries and enhance sustainability results.
- Continuously review and update standards based on feedback from third parties and stakeholders to enhance relevance and applicability.
- Conduct comprehensive assessments of the effectiveness and impact of EU sustainability standards on the block and third parties, considering social, economic, and environmental dimensions.

Output Legitimacy - Corruption issues

- Implement measures to address corruption and improve governance practices in both EU members and exporting countries, fostering transparency and accountability in trade relations.
- The use of independent auditing or verification on sustainable/legal trade in both importing and exporting countries may improve the integrity of trade processes. As it may also increase costs, it should be an additional tool to acceptable forms of checking compliance in EU regulation.

Output Legitimacy - Engagement with private rule-makers

- It is necessary for G20 countries to incentivize private and public rule-makers to fully integrate community-based empowerment practices into private and public schemes and adopt a holistic approach to sustainability. This means that the goal of limiting carbon emissions should be necessarily accompanied by a realistic assessment of local socioeconomic conditions in less developed countries.

- Given the potential effects of public regulations on private certifications, public rule-makers must institutionalize and expand upon existing mechanisms for updating/amending existing rules while assuring broad stakeholder participation.
- State and federal governments should further connect public regulations promoting family agriculture/women participation and existing voluntary standards.



Scenario of outcomes

Unilateral trade policies are designed to achieve climate mitigation results fast. The risk, however, is that the negative externalities generated by those policies lead to low efficacy gains and to questioning of sustainability policies in the future. The recommendations above seek to mitigate that possibility. If thoughtfully adopted, they will help limit some of the legitimacy issues associated with unilateral trade policies while boosting their impacts on the ground. However, these recommendations may generate trade-offs of their own, which require careful consideration. First, there must be a fine-tuning between the involvement of developing countries in the process of discussing the initiatives outlined in this paper and the seek for efficacy. Thus, it is key for the EU to swiftly adapt the implementation of its laws in a way that is WTO consistent, but that also creates new avenues for engagement with Global South countries as a demonstration of willingness to take their views into full account. Furthermore, the involvement of private rule-makers also generates trade-offs of its own. Private rule-makers can worsen the legitimacy gap between Global South stakeholders and foreign policies with extraterritorial impacts as private actors are not directly put in charge by Global South stakeholders. Therefore, engagement with these actors, although by all means relevant, should follow a clear objective and clear metrics as to which partners to involve.

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